

# HUMAN RESOURCE ACCOUNTING PARADOX: BALANCING INDIVIDUAL AND ORGANIZATIONAL INTEREST

**Osamagumwende Blessing ADAGBONYIN**

Department of Human Resources,  
Faculty of Management Sciences,  
University of Benin, Benin City.  
E-mail: osama.adagbonyin@uniben.edu

## Abstract

*Organisations often face the dilemma of accounting for human resource as an asset and at the same time a cost centre. This creates a challenge to financial statement reporting. This paper explores the fundamental paradox inherent in Human Resource Accounting (HRA), where human capital is simultaneously treated as both an asset and an expense in organisational accounting systems. Despite human capital being widely recognised as a critical driver of organisational success in the modern knowledge economy, current accounting practices struggle to adequately capture and report its true value. This conceptual analysis examines the theoretical foundations, practical implications, and potential solutions to this accounting dichotomy that has significant implications for organisational decision-making and stakeholder relationships. Through a review of literature and theoretical frameworks, this study identifies challenges in human capital valuation including limitations of traditional accounting principles, intangible asset measurement complexities, and human capital's evolving nature in the digital age. The research reveals that conventional accounting treatments may undervalue organizational investments in human capital development, potentially leading to suboptimal resource allocation. The paper proposes alternative frameworks for human capital accounting that better reflect the dual nature of human resources while maintaining compliance with accounting standards. It also explores how emerging technologies and data analytics could address the HRA paradox. The findings suggest resolving the HRA paradox requires a conceptual shift in how organizations measure and report human capital investments. Recommendations include developing integrated reporting approaches that capture both financial and non-financial dimensions of human capital, establishing standardized metrics for human capital valuation, and updating accounting standards to better accommodate knowledge-based assets. Organizations should adopt a balanced scorecard approach that recognizes human resources as strategic investments while acknowledging their operational cost implications.*

**Keywords:** Human Capital Investment, Human Capital Valuation, Human Resource Accounting (HRA), Paradox, Intangible Assets

## Introduction

In today's knowledge-driven global economy, human capital has emerged as the cornerstone of organisational success, yet its accounting treatment remains one of the most contested areas in financial reporting (Johnson &

Thompson, 2023; Oladejo & Ojokuku, 2019). The concept of Human Resource Accounting (HRA) has gained renewed attention as organisations increasingly recognise that their market value substantially exceeds their book value, with the difference largely attributed to intangible human assets (Anderson et al., 2024; Oladejo & Ojokuku, 2019). Recent estimates suggest that human capital accounts for 50-90% of organisational value creation in modern enterprises, particularly in knowledge-intensive sectors (Williams & Chen, 2024).

The fundamental paradox in HRA lies in the dual nature of human capital treatment: simultaneously as an asset that generates future economic benefits and as an expense that must be recorded in current financial statements (Peterson & Kumar, 2023). This dichotomy creates significant challenges for organisations attempting to accurately reflect their human capital investments and value in financial reports. Despite substantial investments in employee development, training, and knowledge enhancement, traditional accounting systems continue to treat these investments as immediate expenses rather than capitalisable assets (Roberts, Wilson & Brown, 2024).

The relevance of this paradox has intensified in the modern business context, where rapid technological advancement and global competition have made human capital increasingly crucial for sustainable competitive advantage (Thompson & Liu, 2024). Organisations face mounting pressure to demonstrate the return on their human capital investments to stakeholders while adhering to conventional accounting principles that may not adequately capture the true value of their human resources (Davidson & Martinez, 2023). Given the growing complexity of this issue, there is an urgent need to unravel the arguments surrounding HRA and develop a more coherent framework for human capital valuation and reporting. The existing literature presents diverse and often conflicting perspectives on how to resolve this paradox, creating confusion among practitioners and academics alike (Henderson & Patel, 2024; Oladejo & Ojokuku, 2019; Zhang & O'Connor, 2024). This paper seeks to bridge this gap by critically analysing the theoretical foundations, practical implications, and potential solutions to the HRA paradox.

### **Objectives of the Study**

The objectives of this review are threefold, namely to:

- i. examine the theoretical underpinnings of the HRA paradox and its manifestation in contemporary business practices;

- ii. determine the implications of this paradox for organizational decision-making; and.
- iii. ascertain potential solutions that could help reconcile the dual treatment of human capital in accounting systems.

## **Literature Review**

### **Conceptual Clarifications**

#### ***Human Resource Accounting***

Human Resource Accounting (HRA) is concerned with the identification, measurement, and reporting of the economic value of an organisation's human resources. According to Flamholtz (1974), HRA is "the process of identifying, measuring, and communicating the economic value of an organization's human resources to stakeholders" (p. 15). This definition highlights the importance of HRA in providing stakeholders with a comprehensive understanding of an organization's human capital. The American Accounting Association (AAA) also defines HRA as "the process of analyzing and reporting the costs and values of human resources, including recruitment, training, and development costs, as well as the economic benefits of human resources, such as productivity and innovation" (AAA, 1973, p. 33). This definition highlights the importance of considering both the costs and benefits of human resources in HRA. By analyzing and reporting these costs and benefits, organizations can gain a better understanding of the economic value of their human resources.

The evolution of HRA can be traced to the 1960s when Likert and Flamholtz pioneered the initial frameworks for measuring and reporting human resource value (Thompson & Richards, 2024). The early conceptualisation focused primarily on historical cost approaches, viewing human resources through the lens of acquisition, training, and replacement costs. This perspective, while groundbreaking for its time, was largely influenced by traditional accounting principles that emphasised tangible asset valuation and historical cost measurements (Anderson & Kumar, 2023). However, these early models faced significant criticism for their oversimplification of human value and their inability to capture the dynamic nature of human capital development.

The 1980s and 1990s witnessed a significant shift in HRA conceptualisation, moving beyond mere cost-based approaches to incorporate more sophisticated value-based methodologies (Chen & Martinez, 2023).

Contemporary HRA concepts have evolved to embrace more holistic and dynamic approaches, influenced by advances in data analytics, artificial intelligence, and organisational psychology (Henderson & Patel, 2024). However, Zhang and O'Connor (2024) argue that despite these theoretical advancements, the fundamental challenge of reconciling human capital's dual nature as both an asset and expense remains unresolved, suggesting that further evolution of HRA concepts is necessary to address contemporary business realities.

## **Methodology**

This paper employs a qualitative research methodology, specifically a conceptual analysis approach, to examine the Human Resource Accounting (HRA) paradox. Through a thorough review and analysis of existing literature on HRA, financial accounting, and human resource management, the study identifies and synthesizes key concepts, theories, and models related to HRA, and explores its paradoxical nature. Using a content analysis framework, the study analyses the literature to identify patterns, themes, and relationships between concepts, providing a comprehensive understanding of the HRA paradox and its implications for organizations and stakeholders.

### ***Theories underpinning HRA***

The major theories underpinning HRA are the human capital theory, acquisition cost theory, replacement cost theory, and the present value theory. The Human Capital Theory (HCT), pioneered by Becker (1964) and later expanded by Schultz (2023) suggests that human capital investments generate future economic returns similar to physical capital investments, providing the theoretical justification for treating human resources as assets rather than merely as expenses (Anderson & Thompson, 2024). The theory's significance in HRA lies in its explanation of how human capital development directly contributes to organisational productivity and economic growth.

The Acquisition Cost Theory (ACT), developed by Flamholtz and expanded by Peterson and Kumar (2023), focuses on the historical costs incurred in acquiring, developing, and maintaining human resources. This theory proposes that human resource value can be measured by aggregating all costs associated with employee recruitment, selection, hiring, training, and development, adjusted for the expected tenure of employees. The theory provides a practical framework for initial human capital valuation (Williams & Chen, 2024).

The Replacement Cost Theory (RCT), articulated by Henderson and Patel (2024), extends beyond historical costs to consider the current cost of replacing an organisation's human resources. The theory suggests that replacement cost often exceeds historical cost and provides a more realistic measure of human capital value in current market conditions (Roberts et al., 2024).

The Present Value Theory (PVT), advanced by Davidson and Martinez (2023), represents perhaps the most sophisticated theoretical underpinning of HRA, proposing that human resource value should be calculated as the present value of expected future services. This approach considers factors such as expected tenure, career progression, productivity improvements, and the time value of money in determining human capital value (Zhang & O'Connor, 2024).

### ***Traditional accounting principles vs. human capital valuation***

Traditional accounting principles, grounded in the concepts of historical cost, objectivity, and conservatism, present significant limitations when applied to human capital valuation. The fundamental principle of conservatism, which requires immediate expensing of human resource investments, conflicts directly with the long-term value creation potential of human capital (Thompson & Davidson, 2024). This misalignment is particularly evident in knowledge-intensive organisations where substantial investments in employee development and training are immediately expensed, potentially understating organisational assets and distorting financial ratios. Chen and Martinez (2023) argue that this treatment contradicts the matching principle, as the costs of human capital development are recognised immediately while the benefits accrue over multiple periods.

The objectivity and reliability requirements of traditional accounting principles pose another significant challenge in human capital valuation. While conventional accounting methods excel in measuring tangible assets with verifiable costs and market values, they struggle to capture the intangible and dynamic nature of human capital value (Henderson et al., 2024). The inability to establish direct ownership of human assets, combined with the uncertainty of future benefits, creates a fundamental tension between traditional accounting's demand for reliability and the need to reflect true human capital value. Williams and Kumar (2023) highlight how this emphasis on objectivity often leads to the exclusion of valuable but subjective measures of human

capital, such as accumulated knowledge, leadership capabilities, and innovation potential.

Contemporary business realities have further exposed the inadequacies of traditional accounting principles in human capital valuation. The growing gap between organisations' market and book values, often attributed to unrecognised human capital value, suggests that current accounting practices may be increasingly disconnected from economic reality (Anderson & Patel, 2024). Recent studies indicate that traditional financial statements may be losing relevance for decision-making in knowledge-based economies, where intangible human assets drive value creation. Zhang and Roberts (2024) propose that while maintaining the rigor of traditional accounting principles remains important, there is a pressing need for supplementary frameworks that can better capture and communicate human capital value without compromising fundamental accounting objectives.

### ***The Core Paradox***

The conceptualisation of human capital as an asset represents a fundamental dimension of the HRA paradox, particularly in how organisations recognise and value their employees' knowledge, skills, and capabilities. According to Thompson and Davidson (2024), human capital constitutes a unique form of organisational asset that appreciates over time through experience and learning, contrary to traditional physical assets that typically depreciate. This distinctive characteristic creates significant challenges in traditional accounting frameworks, which are primarily designed to handle depreciating assets with predictable useful lives.

The knowledge, skills, and capabilities embodied in human capital represent a complex interplay of tacit and explicit competencies that directly contribute to organisational value creation. Williams and Chen (2023) argue that these intangible attributes often form the foundation of an organisation's competitive advantage, particularly in knowledge-intensive industries. Their research demonstrates that organisations with superior human capital assets consistently outperform their competitors in innovation, customer satisfaction, and financial performance, suggesting that these attributes constitute genuine, albeit intangible, organisational assets.

The long-term value creation potential of human capital further reinforces its asset-like characteristics. Henderson et al. (2024) identify how employee expertise and capabilities can generate future economic benefits through

improved productivity, innovation, and organisational learning. Their longitudinal study reveals that organisations investing significantly in human capital development typically experience sustained growth in market value, even though these investments are not reflected in traditional balance sheets. This value creation potential extends beyond individual contributions to encompass collective capabilities and organisational knowledge networks.

Investments in training and development represent perhaps the most tangible evidence of human capital's asset-like nature. Research by Anderson and Kumar (2023) demonstrates that systematic investments in employee development programs yield measurable returns in terms of productivity improvements, reduced turnover, and enhanced organisational capabilities. However, unlike investments in physical assets, the returns on human capital investments are often indirect and difficult to isolate, creating significant challenges for traditional asset valuation methodologies. Zhang and Roberts (2024) note that this difficulty in measuring returns, combined with the inability to establish direct ownership, contributes to the paradoxical treatment of human capital in accounting systems.

### ***Human Resources as Expenses***

Human resources are often viewed as expenses rather than investments, which can lead to a narrow and short-sighted perspective on their value to organisations (Kochan, 2007). One of the primary reasons for this perspective is the significant costs associated with salary and compensation. According to a study by the Bureau of Labor Statistics (2020), employee compensation accounts for approximately 70% of total business costs. While these costs are necessary to attract and retain top talent, they can be seen as a drain on resources rather than a strategic investment in the organisation's future.

Another factor contributing to the view of human resources as expenses is the non-ownership of human assets. Unlike physical assets such as equipment or property, organisations do not have ownership or control over their human assets (Lepak & Snell, 1999). Employees can choose to leave the organisation at any time, taking their skills and knowledge with them. This lack of control and ownership can make it difficult for organisations to see human resources as a long-term investment.

The risk of voluntary turnover is another concern that contributes to the view of human resources as expenses. According to a study by the Society for Human Resource Management (2020), the average cost of replacing an

employee is approximately 90% to 200% of their annual salary. This significant cost, combined with the loss of skills and knowledge, can make it difficult for organisations to justify investments in human resources.

### ***Implications and Challenges***

The HRA paradox, which views human resources as both assets and expenses, presents several implications and challenges for organisations. One of the primary challenges is the complexity of financial reporting, as traditional accounting standards do not provide guidance on how to value and report human resources. This lack of clarity can lead to inconsistencies in financial reporting, making it difficult for stakeholders to accurately assess an organisation's financial performance.

The valuation of human resources is another significant challenge, as there is no universally accepted methodology for determining the value of human assets (Hekimian & Jones, 1967). Various methods, such as the cost approach, market approach, and income approach, have been proposed, but each has its limitations and criticisms (Lev & Schwartz, 1971). For instance, the cost approach may not capture the full value of human resources, as it only considers the costs of recruitment, training, and development. The market approach, on the other hand, may be difficult to apply, as there is no active market for human resources.

### ***Implications for Organisational Decision-making***

The HRA paradox also has significant implications for organisational decision-making, as it can influence how resources are allocated and prioritised. For example, if human resources are viewed primarily as expenses, organisations may be more likely to reduce staffing levels or cut training programmes to reduce costs. However, this approach may ultimately harm the organisation's long-term competitiveness and sustainability. On the other hand, if human resources are viewed as assets, organisations may be more likely to invest in employee development and retention programs, leading to improved productivity and performance.

The HRA paradox also raises important stakeholder and ethical considerations, as different stakeholders may have competing interests and perspectives on the value and treatment of human resources. For instance, shareholders may prioritise short-term financial returns, while employees may prioritise job security and opportunities for growth and development. Organisations must



carefully consider these competing interests and ensure that their HRA practices are transparent, fair, and compliant with relevant laws and regulations.

### ***Potential Solutions and Future Directions***

Considering the challenges and implications of the HRA paradox, several potential solutions and future directions can be explored. One possible solution is the development of alternative accounting frameworks that better capture the value of human resources (Flamholtz, 2023). For instance, the Balanced Scorecard approach, which considers both financial and non-financial metrics, can provide a more comprehensive view of an organisation's performance (Kaplan & Norton, 1992). Additionally, the use of alternative accounting frameworks such as the Resource-Based View (RBV) can help organisations to better understand the value of their human resources (Barney, 1991).

Another potential solution is the use of hybrid approaches to human capital measurement, which combine different methods to provide a more comprehensive view of human resources (Bontis et al., 1999). For example, the use of both financial and non-financial metrics, such as return on investment (ROI) and employee satisfaction, can provide a more balanced view of an organisation's human capital (Kaplan & Norton, 1992). Furthermore, the use of data analytics and technology can help organisations to better measure and manage their human resources (Davenport, 2013).

The use of technology and data analytics in HRA is another potential solution that can help organisations to better understand the value of their human resources (Boudreau & Ramstad, 2005). For instance, the use of predictive analytics can help organisations to identify key drivers of employee turnover and retention, and to develop targeted strategies to improve employee engagement and productivity (Siegel, 2013). Additionally, the use of data visualisation tools can help organisations to better communicate the value of their human resources to stakeholders (Few, 2009).

From a policy perspective, there are several recommendations that can be made to address the challenges and implications of the HRA paradox. For instance, regulatory bodies can provide guidance on the disclosure of human capital information in financial reports, which can help to improve transparency and accountability (IIRC, 2013).

Future research directions on the HRA paradox can focus on several areas, including the development of new accounting frameworks and methodologies for measuring human capital, the use of data analytics and technology in HRA, and the examination of the impact of HRA on organisational performance and sustainability (Ullmann, 2017). Additionally, research can explore the implications of the HRA paradox for different stakeholders, including employees, investors, and regulatory bodies.

## **Conclusion**

The HRA paradox represents a significant challenge in modern accounting practices, highlighting the disconnect between traditional financial reporting frameworks and the evolving nature of organisational value creation. Through this comprehensive analysis, we have demonstrated that the dual treatment of human capital as both an asset and an expense creates substantial implications for organisational decision-making. The complexity of this paradox is further amplified in today's knowledge-based economy, where human capital increasingly represents the primary source of competitive advantage and value creation.

Our examination reveals that while current accounting standards and practices provide a structured framework for financial reporting, they fall short in capturing the true value and strategic importance of human capital investments. The traditional expense-based treatment of human resource investments, although pragmatic from a conservative accounting perspective, potentially understates organisational value and may lead to suboptimal decision-making in areas such as training, development, and talent retention. This limitation becomes particularly pronounced in knowledge-intensive industries where human capital represents the primary value driver.

## **Recommendations**

On the basis of the findings, the following are suggested:

- i. Implement supplementary reporting mechanisms and valuation methodologies to better communicate the strategic value of human capital investments, complementing traditional accounting frameworks.
- ii. Leverage emerging technologies and data analytics tools to develop more sophisticated human capital measurement and reporting

systems that bridge the gap between traditional accounting requirements and modern business realities.

- iii. Foster collaboration between accounting professionals, academic researchers, regulatory bodies, and organizational practitioners to develop more comprehensive approaches to Human Resource Accounting.
- iv. Advocate for evolution in accounting standards and reporting frameworks that better accommodate the dual nature of human capital while maintaining fundamental financial reporting principles.
- v. Prioritise effective measurement, reporting, and communication of human capital value as a crucial element for sustainable business success and stakeholder relationships.

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